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In the Supreme Court of the United States

OCTOBER TERM, 1984

UNITED STATES OF AMERICA, ET AL., APPELLANTS

v.

ALVIN HEMME, ET AL.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF ILLINOIS

JURISDICTIONAL STATEMENT

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QUESTION PRESENTED

Whether, in computing the federal estate tax payable by the estate of a decedent who died on November 9, 1978, amendments to the federal tax laws passed by Congress on September 16, 1976, and approved by the President on October 4, 1976, may constitutionally be applied to ascertain the effect upon that computation of gifts made by the decedent on September 28, 1976, and of an election made by him in a federal gift tax return filed on September 30, 1976.

TABLE OF CONTENTS

	Page
Opinion below	1
Jurisdiction	1
Constitutional and statutory provisions involved	2
Statement	2
A. The statutory framework	2
B. The proceedings in this case	7
The question is substantial	9
Conclusion	17
Appendix A	1a
Appendix B	7a
Appendix C	8a
Appendix D	9a

TABLE OF AUTHORITIES

Cases:

Commissioner v. *Estate of Church*, 335 U.S. 632	13
Estate of Ceppi v. *Commissioner*, 698 F.2d 17, cert. denied, 462 U.S. 1120	15
Estate of Gawne v. *Commissioner*, 80 T.C. 478	7
Estate of Renick v. *United States*, 687 F.2d 371	9
Fein v. *United States*, 730 F.2d 1211, cert. denied, No. 84-182 (Oct. 1, 1984)	15
Fernandez v. *Wiener*, 326 U.S. 340	12, 13
First National Bank v. *United States*, 420 F.2d 725, cert. denied, 398 U.S. 950	16
Gwinn v. *Commissioner*, 287 U.S. 224	12, 13
Helvering v. *Hallock*, 309 U.S. 106	13
Milliken v. *United States*, 283 U.S. 15	9, 13, 14, 15
Pension Benefit Guaranty Corp. v. *R.A. Gray & Co.*, No. 83-245 (June 18, 1984)	10, 15, 16
Purvis v. *United States*, 501 F.2d 311, cert. denied, 420 U.S. 947	16

Cases—Continued: Page

Reed v. *United States*, 743 F.2d 481, cert. denied, No. 84-866 (June 3, 1985) 14
Shanahan v. *United States*, 447 F.2d 1082 9
United States v. *Darusmont*, 449 U.S. 292 ....10, 14, 15, 16
United States v. *Hudson*, 299 U.S. 498 16
United States v. *Jacobs*, 306 U.S. 363 .....11, 12, 13
United States v. *Manufacturers National Bank*, 363 U.S. 194 ..... 12, 13
United States v. *Maryland Savings-Share Insurance Corp.*, 400 U.S. 4 11
United States v. *Wells*, 283 U.S. 102 13
Untermyer v. *Anderson*, 276 U.S. 440 .....9, 14, 15

Constitution, statutes and regulation:

U.S. Const. Amend. V (Due Process Clause) 2, 8, 10, 13, 9a

Internal Revenue Code of 1954 (26 U.S.C.):

§ 2001 4
§ 2001 (1970 ed.) 11
§ 2010 4
§ 2010(b) (1976 ed.) 8
§ 2010(c) 7, 8, 10, 11, 12, 13, 14
§ 2012 4
§ 2012 (1970 ed.) 3
§ 2035 (1970 ed.) 3
§ 2036 (1970 ed.) 3
§ 2052 4
§ 2052 (1970 ed.) 3, 4, 11
§ 2501(a) 5
§ 2502 ..... 3, 5
§ 2502(a) 4
§ 2503(b) (1970 ed.) 8
§ 2505 4
§ 2505(c) 7
§ 2521 4
§ 2521 (1970 ed.) 3, 4, 11a

Revenue Act of 1932, ch. 209, Tit. III, 47 Stat. 245 *et seq.* 3

Constitution, statutes and regulation—Continued: Page

Tax Reform Act of 1976, Pub. L. No. 94-455, Tit. XX, 90 Stat. 1846 *et seq.* 4
§ 2001(a)(1), 90 Stat. 1846 4
§ 2001(a)(2), 90 Stat. 1848 4
§ 2001(a)(3), 90 Stat. 1848 4
§ 2001(a)(4), 90 Stat. 1848 4
§ 2001(b)(1), 90 Stat. 1849 4
§ 2001(b)(2), 90 Stat. 1849 4
§ 2001(b)(3), 90 Stat. 1849 4
Treas. Reg. § 20.2012-1 (1970) 4

Miscellaneous:

Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935) 15
Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692 (1960) 15
H.R. 14844, 94th Cong., 2d Sess. (1976) 6
H.R. Conf. Rep. 94-1515, 94th Cong., 2d Sess. (1976) 7
H.R. Rep. 94-1380, 94th Cong., 2d Sess. (1976) 6
J. McCord, *1976 Estate and Gift Tax Reform: Analysis, Explanation and Commentary* (1977) .. 4, 7
S. Conf. Rep. 94-1236, 94th Cong., 2d Sess. (1976) .. 7
R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation* (5th ed. 1983) 7

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JURISDICTIONAL STATEMENT

OPINION BELOW

The order of the district court (App., *infra*, 1a-6a) is unreported.

JURISDICTION

The judgment of the district court (App., *infra*, 7a) was entered on January 23, 1985. A notice of appeal (App., *infra*, 8a) was filed on February 21, 1985. On April 16, 1985, Justice Stevens extended the time for docketing the appeal to and including June 21, 1985. The jurisdiction of this Court is invoked under 28 U.S.C. 1252. A direct appeal lies where, as here, a federal statute has been held unconstitutional as applied. *United States* v. *Darusmont*, 449 U.S. 292, 293 (1981) (per curiam).

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

The relevant constitutional and statutory provisions are set out in a statutory appendix (App., *infra*, 9a-11a).

STATEMENT

In 1976, Congress significantly changed the relationship between the federal gift tax and the federal estate tax. Previously, a taxpayer was entitled to a $30,000 lifetime gift-tax exemption for inter vivos transfers, and his estate was entitled to a $60,000 estate-tax exemption for transfers at death. Congress in 1976 replaced these two exemptions with a "unified credit." In an effort to produce continuity between the two tax regimes, Congress provided in 1976 that a person (or the estate of a person) who had claimed the $30,000 gift tax exemption for certain gifts could not later claim the full "unified credit" against the gift or estate tax. Rather, the "unified credit" in such circumstances was required to be reduced to reflect the transfer tax benefit that the individual had already garnered. The district court held that this transitional rule was a species of retroactive legislation and that it was so arbitrary and capricious as to render it unconstitutional under the Due Process Clause of the Fifth Amendment.

A. The Statutory Framework

1. Prior to 1977, the estate tax and the gift tax, while functionally related, were separately imposed, separately administered, and separately collected. The gift tax is recurrent (*i.e.*, collected on an annual or quarterly basis) and, to guarantee progressivity, it has always been cumulative. All taxable gifts

made by a taxpayer after June 6, 1932, in other words, are aggregated in order to determine the tax rate or "bracket" applicable to a particular gift.[1] The gift tax provided an annual, per-donee exclusion ($3,000 in 1976, $10,000 now). It also provided a lifetime "specific exemption"—basically a deduction—in the amount of $30,000 (26 U.S.C. (1970 ed.) 2521). A taxpayer could claim the "specific exemption," in whole or in part, whenever he chose. The estate tax, of course, has never been recurrent, but is imposed at fixed rates on the taxable estate at death. In 1976 it provided a $60,000 exemption—again, basically a deduction—in determining the taxable estate (26 U.S.C. (1970 ed.) 2052).

Though separate in most aspects, the gift and estate taxes were never entirely unconnected. From the beginning, it was clear that some property, the lifetime transfer of which was subject to gift tax, might also be included in the transferor's estate for estate tax purposes. Common examples were gifts in contemplation of death (26 U.S.C. (1970 ed.) 2035) and transfers with a retained life interest (26 U.S.C. (1970 ed.) 2036). To alleviate the double tax burden in such situations, Congress provided that, where the transfer of property includable in the gross estate had previously been subject to gift tax, a credit was allowable against the estate tax for the gift tax paid (26 U.S.C. (1970 ed.) 2012).[2]

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[1] See 26 U.S.C. 2502. The cumulation begins with June 6, 1932, the date the gift tax was reimposed. Revenue Act of 1932, ch. 209, Tit. III, 47 Stat. 245 *et seq.*

[2] Because of possible differences in value at the time of the gift and at the time of the decedent's death, differences in the amount of the taxable estate and the aggregate taxable gifts,

2. In the Tax Reform Act of 1976, Pub. L. No. 94-455, Tit. XX, 90 Stat. 1846 *et seq.*, Congress substantially integrated the estate and gift taxes without greatly altering the coverage of either. The first step was to bring the two rate structures—previously, gift tax rates were 75% of estate tax rates on comparable transfers—into conformity.[3] Then, in lieu of the $30,000 "specific exemption" from the gift tax and the $60,000 exemption from the estate tax, Congress provided a credit, termed the "unified credit," available against either or both taxes as first incurred.[4] Finally, a somewhat intricate mechanism for unification was supplied by providing that the estate tax should be determined (subject to the "unified credit") by a computation that first aggregated the taxable estate and taxable gifts made after December 31, 1976; computed a tax on that aggregate sum; and then reduced the result by the gift tax payable on the gifts thus included.[5] Roughly speaking, the result was to treat the taxable estate as the "ultimate taxable gift." See generally J. McCord, *1976 Estate and Gift Tax Reform: Analysis, Explanation and Commentary* (1977).

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and different rates and structures, computation of the gift tax credit was, to say the least, complex. See Treas. Reg. § 20.2012-1 (1970).

[3] See Pub. L. No. 94-455, § 2001(b)(1), 90 Stat. 1849 (amending 26 U.S.C. 2502(a)).

[4] See Pub. L. No. 94-455, § 2001(a)(2), (3) and (4), 90 Stat. 1848 (adding 26 U.S.C. 2010, amending 26 U.S.C. 2012 and repealing 26 U.S.C. (1970 ed.) 2052); Pub. L. No. 94-455, § 2001(b)(2) and (3), 90 Stat. 1849 (adding 26 U.S.C. 2505 and repealing 26 U.S.C. (1970 ed.) 2521).

[5] Pub. L. No. 94-455, § 2001(a)(1), 90 Stat. 1846 (amending 26 U.S.C. 2001).

The 1976 Act was effective with respect to estates of decedents dying after December 31, 1976, and with respect to gifts made after that date. But while the Act ushered in a measure of integration between the two tax regimes, it did not purport to provide a completely fresh start, and could hardly have done so. Continuity with the past necessarily had to be provided for. The estate of a decedent dying after 1976, for example, would continue in many cases to include assets that he had disposed of before 1977, such as property transferred in contemplation of death or with a retained life interest. Where such prior transfers had been subject to gift tax, the gift tax previously paid would produce a credit against the post-1976 estate tax. And because the gift tax itself remained cumulative, gifts made before 1977 continued to affect the impact of the (higher) gift tax rates applicable to gifts made during or after that year. See 26 U.S.C. 2501(a), 2502.

Most relevant for present purposes, a nettlesome question of continuity arose from the fact that the $30,000 "specific exemption" from the gift tax, which a taxpayer could employ at the time or times of his choice, was, together with the $60,000 exemption from the estate tax, to be repealed, and the new "unified credit," applicable against either or both taxes, was to be substituted therefor. Obviously, some taxpayers would have employed all or part of the $30,000 specific exemption against pre-1977 gifts. The question was whether this fact should call for an adjustment in the unified credit that they or their estates might subsequently claim.

The bill reported by the House Ways and Means Committee on August 6, 1976, answered this question in the affirmative. It provided that if the specific

exemption had been claimed by a taxpayer in whole or in part at any time after June 6, 1932, the unified credit otherwise allowable was to be reduced by 20% of the amount so claimed. H.R. 14844, 94th Cong., 2d Sess. §§ 2010(c), 2505(c) (1976) (set forth at H.R. Rep. 94-1380, 94th Cong., 2d Sess. 94, 131 (1976)). The Committee explained its proposal as follows (H.R. Rep. 94-1380, at 16):

> As a transitional rule, the unified credit allowable is to be reduced by an amount equal to 20 percent of the amount allowed as a specific exemption in computing taxable gifts under present law. Thus, in the case where a donor had benefited from the use of the full $30,000 gift tax specific exemption under present law, the maximum unified credit allowable would be reduced by $6,000.

Although the legislative history does not address the matter, the 20% figure was apparently chosen because it was thought to approximate the average effective gift tax rate, and thus to represent the average transfer tax benefit realized by decedents who previously had claimed some or all of the $30,000 specific exemption.

The Conference Committee, in adding provisions of H.R. 14844 to the pending Tax Reform Act of 1976, limited the scope of this transitional rule. It decided that the transitional rule should apply, not in the case of all gifts made after June 6, 1932, but only in the case of gifts made after September 8, 1976—the date the Conference Committee approved the measure. The Committee reports do not explain the reason for thus limiting the scope of the transitional

rule.[6] But the transitional rule, with the limitation added in conference, has uniformly been understood to serve the objective of removing the incentive to make large gifts during the period between September 8, 1976, and January 1, 1977—gifts that otherwise would have provided a double tax benefit in the form of a $30,000 "specific exemption" under the old regime coupled with an undiminished "unified credit" under the new. See *Estate of Gawne* v. *Commissioner*, 80 T.C. 478, 483 (1983); R. Stephens, G. Maxfield & S. Lind, *Federal Estate and Gift Taxation* ¶ 3.02, at 3-4 n.9 (5th ed. 1983); J. McCord, *supra*, § 2.13, at 26.

The Tax Reform Act of 1976, incorporating the transitional rule described above, was passed by both Houses of Congress on September 16, 1976. It was signed by the President on October 4, 1976. The transitional rule is currently codified in 26 U.S.C. 2010(c) and 2505(c).

B. The Proceedings in this Case

The facts were stipulated, and the case was submitted to the district court on those stipulated facts. On September 28, 1976, Charles Hirschi made gifts aggregating $45,000 in value to five persons (App., *infra*, 2a). Two days later, he reported those gifts on a federal gift tax return, which indicated no tax due (*id.* at 2a-3a). The first $15,000 of his gifts, consisting of $3,000 transfers to each of the five recipients, was exempt from gift tax by virtue of the

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[6] Each report states simply that "the unified credit is not to be reduced for any amount allowed as a specific exemption for gifts made prior to September 9, 1976." H.R. Conf. Rep. 94-1515, 94th Cong., 2d Sess. 607-608 (1976); S. Conf. Rep. 94-1236, 94th Cong., 2d Sess. 607-608 (1976).

annual per-donee exclusion (26 U.S.C. (1970 ed.) 2503(b)). As to the $30,000 balance, Hirschi elected to apply the full amount of his lifetime "specific exemption," thus eliminating any tax (App., *infra*, 1a-2a).

About two years later, on November 9, 1978, Hirschi died (App., *infra*, 2a). Appellee Farmers & Merchants Bank filed a federal estate tax return on behalf of the estate. On that return, the $45,000 in gifts described above were included in the gross estate as gifts in contemplation of death (*ibid.*). The estate claimed a "unified credit" of $34,000, the maximum amount then allowable. See 26 U.S.C. (1976 ed.) 2010(b). On audit, the Commissioner determined that, since Hirschi had claimed a $30,000 specific exemption for gifts made after September 8, 1976, the "unified credit" allowable to his estate had to be reduced by $6,000—20% of the $30,000 specific exemption previously claimed—under the transitional rule of Section 2010(c). The Commissioner accordingly asserted a deficiency in estate taxes in the amount of $6,000 (App., *infra*, 2a).

Appellees paid the asserted deficiency, filed a claim for refund, and eventually brought this refund suit in the United States District Court for the Southern District of Illinois. They contended inter alia that, if Section 2010(c) were applied in the case of gifts made before the enactment of the Tax Reform Act of 1976 on October 4, 1976, it would to that extent be retroactive, and would thus violate the Fifth Amendment by depriving them of property without due process of law.[7]

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[7] Appellees also contended that, as a matter of statutory interpretation, Section 2010(c) should be construed as inapplicable if the property with respect to which the specific

The district court recited that "[t]he first issue raised by the plaintiffs which we will address concerns whether the retroactive provision of [26 U.S.C.] 2010 is unconstitutional and thus violates the due process clause of the Fifth Amendment" (App., *infra*, 3a). The court acknowledged (*id.* at 3a-4a) that this Court has repeatedly upheld retroactive application of income tax legislation, but on the asserted authority of *Shanahan* v. *United States*, 447 F.2d 1082 (10th Cir. 1971), stated that those decisions do not apply to transfers subject to the estate and gift tax laws. Rather, the court reasoned, this case was controlled by *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), where the Court held that the federal gift tax, newly imposed in 1924, could not constitutionally be applied to gifts completed before its enactment. The court found *Milliken* v. *United States*, 283 U.S. 15 (1931), which upheld the application of an amended estate tax statute to a previously-completed gift in contemplation of death, distinguishable. The court held that "the tax under Section 2010(c) as applied to this transaction is so arbitrary and capricious as to render it unconstitutional" (App., *infra*, 6a). It accordingly entered judgment for the appellees (*id.* at 7a).

THE QUESTION IS SUBSTANTIAL

The district court has squarely invalidated a federal tax statute on grounds of repugnancy to the Con-

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exemption had been claimed was included in the decedent's gross estate. (As noted above, the decedent's September 28, 1976, gifts were included in his gross estate as gifts in contemplation of death.) Appellees' statutory argument had been squarely rejected in *Estate of Renick* v. *United States*, 687 F.2d 371 (Ct. Cl. 1982), and the court below did not consider it.

stitution. Although the statute invalidated is a relatively obscure transitional rule, the decision below has ramifications far beyond the revenue involved in this particular case. The district court's reasoning is broad and would disable Congress from enacting any amendment to the estate or gift tax laws—and perhaps amendments to the income tax laws as well—containing retrospective features of any sort. The decision below thus threatens to affect adversely the administration of the revenue by circumscribing what had heretofore been regarded as the unquestioned prerogative of Congress in enacting tax statutes. The decision below is plainly erroneous, and the principles governing the constitutionality of retroactive legislation, especially tax legislation, are well settled, having been established by a long line of decisions culminating in *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, No. 83-245 (June 18, 1984). For these reasons, the Court may wish to consider summary reversal, the course it followed in *United States* v. *Darusmont*, 449 U.S. 292 (1981) (per curiam).

1. The district court held that the challenged transitional rule violated the Fifth Amendment's prohibition against depriving any person of property without due process of law. But appellees were deprived of no property, with or without due process. The estate tax assessed by the Commissioner, after reducing the allowable unified credit from $34,000 to $28,000 pursuant to Section 2010(c), was $87,690.56 (Stip. ¶¶ 8 & 10; Stip. Exhs. C & D). On the other hand, had the tax laws not been amended in 1976, and had the provisions of the Internal Revenue Code as it existed on September 28, 1976, when the decedent made his gifts, been applied to his estate, the estate tax would have been $88,345.72 (see Stip. Exh.

C; 26 U.S.C. (1970 ed.) 2001, 2052). The Tax Reform Act of 1976, signed by the President on October 4, 1976, thus reduced the estate tax due from the Hirschi estate, and saved appellees $655.16. It can scarcely be said to have deprived them of property.

It is of course true that Congress did not extend to the Hirschi estate the same double tax benefit that it effectively made available to persons (and estates of persons) who claimed the specific exemption for gifts made before September 9, 1976, and who in consequence were not covered by the transitional rule. But Congress's decision not to extend that benefit to people like appellees did not deprive them of property. Such line-drawing is an inherent feature of tax legislation. See *United States* v. *Maryland Savings-Share Insurance Corp.*, 400 U.S. 4 (1970).

2. Contrary to the district court's statement, the application of Section 2010(c) to appellees does not constitute "retroactive" legislation, and the court thus erred in subjecting it to heightened due process scrutiny. The decedent when he made his gifts got the full benefit of the then-existing $30,000 specific exemption for gift tax purposes. The Tax Reform Act of 1976 was signed by the President one week later, and thus became law more than two years before Hirschi died. When he died, his estate got the benefit of the then-existing (albeit reduced) unified credit. It is true that this credit was reduced by reference to gifts Hirschi had made two years earlier. But this Court has regularly held that an estate tax provision which is effective at the date of death "does not operate retroactively merely because some of the facts or conditions upon which its application depends came into being prior to the enactment of the tax." *United States* v. *Jacobs*, 306 U.S. 363, 367 (1939)

(footnote omitted). Accord, *United States* v. *Manufacturers National Bank*, 363 U.S. 194, 200 (1960).[8]

Indeed, the application of the estate tax regularly depends on facts and conditions that may have come into being before the operative estate tax provision was enacted. As noted above, the estate tax has never been limited to property owned by the decedent at the time of his death, but has always, in its original form and as variously amended, included in the decedent's gross estate property transferred or other-

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[8] In *Jacobs*, the decedent had paid for property and had it conveyed to himself and his wife as joint tenants in 1909, seven years before the estate tax was enacted (306 U.S. at 364). He died after the Revenue Act of 1924 required that jointly held property be included in the gross estate of a decedent who had furnished the consideration for the transfer. The Court noted that the challenged estate tax "was not levied on the 1909 transfer," but on the testamentary transfer that occurred after the law was amended in 1924, and accordingly held that the amendment "was not retroactive" (306 U.S. at 366). In *Manufacturers National Bank*, the decedent in 1936 had divested himself of ownership of a life insurance policy at a time when that would have removed the policy or its proceeds from his gross estate (363 U.S. at 196). The decedent, however, had continued to pay the premiums on the policy until he died (*ibid.*). He died in 1954, after the Revenue Act of 1942 made payment of premiums a test for inclusion of life insurance proceeds in the insured's gross estate. The court held that the 1942 amendment, having become effective long before the decedent died, "cannot be said to be retroactive in its impact"; the fact that "the policies were purchased and the policy rights were assigned before the statute was enacted," the Court said, was "not material" (363 U.S. at 200). If neither of these cases involved retroactivity, it is clear that the district court erred in characterizing the application of Section 2010(c) as retroactive here. See also *Fernandez* v. *Wiener*, 326 U.S. 340 (1945); *Gwinn* v. *Commissioner*, 287 U.S. 224 (1932).

wise acted upon by him at some earlier time. This Court has not suggested that the estate tax operates "retroactively" simply because that "earlier time" is a time before enactment of the statutory provision dictating how such property or its transfer shall be treated for estate tax purposes. See, *e.g.*, *United States* v. *Wells*, 283 U.S. 102 (1931); *Gwinn* v. *Commissioner*, 287 U.S. 224 (1932); *United States* v. *Jacobs*, 306 U.S. 363 (1939); *Helvering* v. *Hallock*, 309 U.S. 106 (1940); *Fernandez* v. *Wiener*, 326 U.S. 340 (1945); *Commissioner* v. *Estate of Church*, 335 U.S. 632 (1949); *United States* v. *Manufacturers National Bank*, 363 U.S. 194 (1960).

3. Even if Section 2010(c)'s transitional rule were thought to deprive appellees of property, and to do so "retroactively" by virtue of its look-back feature, its effect is not so harsh or oppressive as to render it unconstitutional under the Due Process Clause. This Court has squarely rejected the idea that retroactivity in an estate tax statute necessarily invalidates it, pointing out that "a tax is not necessarily and certainly arbitrary and therefore invalid because retroactively applied, and taxing acts having retroactive features have been upheld in view of the particular circumstances disclosed and considered by the Court." *Milliken* v. *United States*, 283 U.S. 15, 21 (1931). The Court in *Milliken* upheld the application of (higher) estate tax rates imposed by an amended statute to a previously-completed gift in contemplation of death, and also held that the gift could be valued for estate tax purposes at the date of death rather than at the time the gift was made.

This case involves a transitional rule designed to prevent taxpayers from manipulating the timing of their gifts so as to derive a double tax benefit from

the shift to a "unified credit" estate-and-gift-tax regime. The decedent here, having elected on September 30, 1976, to claim the full $30,000 specific exemption permitted to him for the gifts he had made two days before, had no claim under the then-existing statute to any further exemption, or to its equivalent in the form of some future tax benefit. Under the version of the transitional rule adopted by the House Ways and Means Committee, the decedent would likewise have been entitled to no further exemption, or to its equivalent in the form of an undiminished unified credit, either for his September 28 gifts or for any gifts he had made after June 6, 1932. See page 6, *supra*. He gained no greater entitlement to a double tax benefit by virtue of the Conference Committee's decision to limit the application of the transitional rule to gifts made after September 8, 1976. That decision might be thought to confer a windfall on taxpayers who had the good fortune to make gifts before the Conference Committee acted, but, as noted above, such line-drawing is the function of legislation. The application of the transitional rule to appellees was plainly not "so harsh and oppressive as to be a denial of due process" (*United States* v. *Darusmont*, 449 U.S. at 299).[9]

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[9] The district court erred in invoking *Untermyer* v. *Anderson*, 276 U.S. 440 (1928), to support its holding that Section 2010(c)'s transitional rule is unconstitutional. As has repeatedly been pointed out on the frequent occasions when that decision has been distinguished, *Untermyer* involved the retroactive application of the first gift tax—a wholly new tax enacted in 1924—to gifts irrevocably completed before its effective date. See, *e.g.*, *United States* v. *Darusmont*, 449 U.S. at 299; *Milliken* v. *United States*, 283 U.S. at 21; *Reed* v. *United States*, 743 F.2d 481, 486 (7th Cir. 1984), cert. denied, No. 84-866 (June 3, 1985); *Fein* v. *United States*, 730 F.2d

4. Finally, the decedent in this case "had ample advance notice" (*United States* v. *Darusmont*, 449 U.S. at 299) of the proposed change in the tax laws. The House Ways and Means Committee approved its (more restrictive) version of the transitional rule on August 6, 1976. The Conference Committee approved on September 8, 1976, the version that was eventually enacted. The bill passed both houses of Congress on September 16, 1976. All these events occurred before the decedent made his gifts on September 28, 1976, and he thus had constructive notice about what the effect of claiming his $30,000 specific exemption would be. This Court has regularly held that there is no constitutional impediment to making a statute effective (as here) from the date of public notice. *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, slip op. 13-14 ("assuming that advance notice of legislative action with retrospective effects is constitutionally compelled, * * * we believe that employers had ample notice" of the contingent liability imposed by an amended pension statute); *United States* v.

1211, 1213-1214 (8th Cir. 1984), cert. denied, No. 84-182 (Oct. 1, 1984) ("the modern trend of decisions has uniformly been to limit" *Untermyer* to the "narrow situation" there involved); *Estate of Ceppi* v. *Commissioner*, 698 F.2d 17, 21 (1st Cir.), cert. denied, 462 U.S. 1120 (1983) (collecting cases and concluding that, in light of *Milliken*'s distinction of *Untermyer*, "*Untermyer* at best remains good law only for the proposition that a wholly new gift tax cannot be applied retroactively"); Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 Harv. L. Rev. 692 (1960); Ballard, *Retroactive Federal Taxation*, 48 Harv. L. Rev. 592 (1935). The *Untermyer* decision has no relevance to this case, which involves an amendment to an existing tax statute, and which, as pointed out above, does not in any event operate retroactively.

Darusmont, 449 U.S. at 299 (same, amended tax statute); *United States* v. *Hudson*, 299 U.S. 498 (1937).

Especially should this be so where, as here, a provision with retrospective effects is adopted to prevent a "rush to the door" by persons seeking to circumvent the purpose of the legislation. See *Pension Benefit Guaranty Corp.* v. *R.A. Gray & Co.*, slip op. 10-13.[10] The starting date chosen by the Conference Committee for the transitional rule—September 8, 1976—was not chosen arbitrarily, but was the date the Committee approved the bill in question. It was neither harsh, oppressive, nor arbitrary for Congress to remove the incentive for taxpayers to seek the double tax benefit of a $30,000 gift tax exemption, plus an undiminished unified credit, by making gifts after that date and before the January 1, 1977, effective date of the new law.

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[10] See also *Purvis* v. *United States*, 501 F.2d 311 (9th Cir. 1974), cert. denied, 420 U.S. 947 (1975) (sustaining application of the interest-equalization tax, designed to stem outflow of investment capital from the United States, retroactively to transactions consummated during the previous year); *First National Bank* v. *United States*, 420 F.2d 725 (Ct. Cl.), cert. denied, 398 U.S. 950 (1970) (same).

CONCLUSION

Probable jurisdiction should be noted and the judgment of the district court should be reversed.

Respectfully submitted.

CHARLES FRIED
Acting Solicitor General

GLENN L. ARCHER, JR.
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ERNEST J. BROWN
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JUNE 1985

APPENDIX A

IN THE UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF ILLINOIS

No. 83-5069

ALVIN HEMME, DENNIS HEMME and RON HEMME, and FARMERS AND MERCHANTS BANK OF HIGHLAND, a corporation, as TRUSTEE OF THE REVOCABLE LIVING TRUST OF CHARLES W. HIRSCHI, PLAINTIFFS

vs.

UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY OF THE UNITED STATES OF AMERICA, and COMMISSIONER OF INTERNAL REVENUE, DEFENDANTS

[Filed Jan. 23, 1985]

ORDER

This is a civil action for the refund of federal estate taxes which the plaintiffs allege were erroneously assessed and collected. The parties have requested that the court make a ruling based upon the briefs filed and on stipulation of facts submitted. After hearing oral arguments the matter was taken under advisement.

On September 28, 1976, Charles W. Hirschi made gifts to five individuals totalling $45,000.00. In reporting these gifts on September 30, 1976 on his federal gift tax return Mr. Hirschi elected to apply the specific exemption of the then existing IRC Section 2521 in the amount of $30,000.00. This served to exempt $30,000.00 of the gifts from federal gift tax. The remaining $15,000.00 of gifts were also exempted by virtue of the $3000.00 per donee exclusion of Section 2503(b) of the IRC.

On November 9, 1978, Mr. Hirschi died. The decedent's estate filed a timely federal estate tax return. The $45,000.00 worth of gifts made on September 28, 1976, were included on the return as part of decedent's estate by virtue of IRC Section 2035 which required the inclusion in the estate of gifts made in contemplation of death. In calculating the amount of estate tax due, the estate claimed a unified tax credit in the amount of $34,000.00. This was the maximum unified credit then available under Section 2521 of the IRC. In auditing the estate tax return the IRS determined that the $34,000.00 unified credit claimed by the estate must be reduced by $6000.00 because the decedent had previously used his $30,000.00 gift tax specific exemption in connection with his September 28, 1976 gifts. Accordingly, an assessment with respect to the disallowed amount was made against the estate and paid by the estate. The estate then filed a claim with the IRS for a refund which was denied. This suit was subsequently filed.

The Tax Reform Act of 1976 (Act), enacted October 4, 1976, adopted a single state [*sic*] and gift tax rate schedule. Under prior law a donor was entitled to a specific exemption in the amount of $30,000.00 for gift tax purposes and the estate of decedent was en-

titled to a $60,000.00 specific exemption for estate tax purposes. The Act replaced the specific exemptions with respect to gifts made after December 31, 1976 and with respect to the estate of persons dying in 1977 and thereafter with a unified credit. The statute provided that the unified credit be phased in over a five year transaction [*sic*] period, beginning at $30,000.00 for the year 1977 and up to $47,000.00 for 1981 and the years thereafter. As part of the transition, Congress provided for an interim period between September 8, 1976, and January, 1977 whereby the unified credit allowed the estate would be reduced by 20% on all gifts made during the interim period where the $30,000.00 specific exemption was used for gift tax purposes.

Because the decedent made his gift on September 28, 1976, which date fell within the interim period, the credit allowed Mr. Hirschi's estate was reduced by 20%. The first issue raised by the plaintiffs which we will address concerns whether the retroactive provision of 29 [*sic*] USC Section 2010 is unconstitutional and thus violates the due process clause of the Fifth Amendment.

The United States Supreme Court has held that Congress may provide for the retroactive operation of income tax legislation. *Welch v. Henry*, 305 U.S. 134, 59 S.Ct. 121, 83 L.Ed. 87 (1938); *United States v. Hudson*, 299 U.S. 498, 57 S.Ct. 309, 81 L.Ed. 370 (1937); *Lynch v. Hornby*, 247 U.S. 339, 38 S.Ct. 543, 62 L.Ed. 1149 (1918). However, the justification for upholding retroactive income taxation does not apply to estate and gift tax because it cannot be assumed that the taxpayer would dispose of his property in the same manner had he known the tax consequences of his act. *Shanahan v. U.S.*, 447 F.2d 1082 (10th Cir. 1971).

The case of *Untermeyer v. Anderson*, 276 U.S. 440, 48 S.Ct. 353, 72 L.Ed. 645 (1928) is similar to the case before us. The Revenue Act of 1924 imposed a tax on all gifts made during the calendar year of 1924 although it did not go into effect until June 2, 1924. In *Untermeyer*, the constitutionality of the tax as applied to a gift made on May 23, 1924, just 12 days before the Act was approved by the President was at issue. Prior to its decision in *Untermeyer*, the court had held the tax unconstitutional as applied to a gift made in January 1924 on the ground that it was so arbitrary as to be a denial of due process. *Blodgett v. Holden*, 275 U.S. 142, 48 S.Ct. 105, 72 L.Ed. 206 (1927). In that case the court stated that "it seems wholly unreasonable that one who, in entire good faith and without the slightest premonition of such consequence, made absolute disposition of his property by gifts should thereafter be required to pay a charge for so doing." 48 S.Ct. at 106. In *Untermeyer*, the government argued that as retroactively applied to this gift the tax was not unconstitutional because the taxpayer had ample notice of the proposed tax and in all likelihood, had made the gift at that particular time to avoid tax liability. The court rejected the argument holding the retroactive application of the tax unconstitutional. The court stated:

> The mere fact that a gift was made while the bill containing the questioned provisions was in the last stage of progress through Congress we think is not enough to differentiate this cause from the former one and to relieve the legislation of the arbitrary character there ascribed to it. To accept the contrary view would produce insuperable difficulties touching interpretation

> and practical application of the statute and render impossible proper understanding of the burden intended to be imposed. The taxpayer may justly demand to know when and how he becomes liable for taxes—he cannot foresee and ought not to be required to guess the outcome of pending measures. The future of every bill while before Congress is necessarily uncertain. The will of the lawmakers is not definitely expressed until final action thereon has been taken.
> 48 S.Ct. at 354.

There have been cases however where a retrospective tax on an estate and gifts has been upheld. *Milliken v. The United States*, 283 U.S. 15, 51 S.Ct. 324, 75 L.Ed. 809 (1931); *Estate of Renick v. United States*, 687 F.2d 371 (Court of Claims 1982). We feel these cases are distinguishable from the case at bar.

In *Milliken* the court held the Revenue Act of 1918 applicable to a gift made in 1916 for estate tax purposes. This holding was based on the similarity of the two statutes. The court found the only difference between the statutes was one of tax rate. The court further noted that the decedent could have anticipated the tax.

The defendant relies on the *Renick* decision for the proposition that the retrospective nature of the Tax Reform Act of 1976 is not so arbitrary and capricious as to render the statute unconstitutional. In *Renick*, the decedent made a gift of $100,000.00 on December 30, 1976, two months after the enactment of the statute here in question. Because the gift was made 2 months after the statute's enactment, the court held that the decedent was afforded a choice in determining how to handle the transaction. The court

stated that "the decedent was afforded a reasonable means or choice to avoid the application of Section 2010(c) to his gift." *Renick* at 377.

In the present case Mr. Hirschi had no such choice. His gift was made and his gift tax returns filed before the statute's enactment. Although the decedent taxpayer, like the taxpayer in *Untermeyer*, may have had notice of the proposed tax he should not be required to guess on what the leglislative outcome would be.

Accordingly, we hold that the tax under Section 2010(c) as applied to this transaction is so arbitrary and capricious as to render it unconstitutional.

IT IS SO ORDERED.

DATED: This 23rd day of January, 1985.

/s/ William L. Beatty
WILLIAM L. BEATTY
United States District Judge

Note: Clerk to Forward Copies to All Parties.

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

Docket Number 83-5069

ALVIN HEMME, ET AL.

v.

UNITED STATES OF AMERICA, ET AL.

[Filed Jan. 23, 1985]

JUDGMENT IN A CIVIL CASE

☐ Jury Verdict. This action came before the Court and a jury with the judicial officer named above presiding. The issues have been tried and the jury has rendered its verdict.

☒ Decision by Court. This action came to trial or hearing before the Court with the judge (magistrate) named above presiding. The issues have been tried or heard and a decision has been rendered.

IT IS ORDERED AND ADJUDGED that judgment is entered in favor of plaintiffs and against defendants.

/s/ A. Marvin Helart
A. MARVIN HELART
Deputy Clerk

/s/ M. Ruth Brooks
M. RUTH BROOKS

APPENDIX C

IN THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF ILLINOIS

Civil Action No. 83-5069

ALVIN HEMME, DENNIS HEMME and RON HEMME, and FARMERS AND MERCHANTS BANK OF HIGHLAND, a corporation, as TRUSTEE OF THE REVOCABLE LIVING TRUST OF CHARLES W. HIRSCHI, PLAINTIFFS

v.

UNITED STATES OF AMERICA, DEPARTMENT OF THE TREASURY OF THE UNITED STATES OF AMERICA, and COMMISSIONER OF INTERNAL REVENUE, DEFENDANTS

[Filed Feb. 21, 1985]

NOTICE OF APPEAL

NOTICE is hereby given that, pursuant to 28 U.S.C., Section 1252, the defendants hereby appeal to the Supreme Court of the United States from the order and judgment entered herein on January 23, 1985, a copy of which is annexed hereto.

FREDERICK J. HESS
United States Attorney

By: /s/ Robert Simpkins
ROBERT SIMPKINS
Assistant United States Attorney

/s/ Terri E. Schapiro
TERRI E. SCHAPIRO
Trial Attorney, Tax Division
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APPENDIX D

The Due Process Clause of the Fifth Amendment to the United States Constitution provides:

> No person shall * * * be deprived of life, liberty, or property, without due process of law; * * *

Internal Revenue Code of 1954 (26 U.S.C. (1970 ed.)):

> Section 2010 [as added by Section 2001(a)(2) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1848]. UNIFIED CREDIT AGAINST ESTATE TAX.
>
> (a) *General Rule.*—A credit of $47,000 shall be allowed to the estate of every decedent against the tax imposed by section 2001.
>
> (b) *Phase-in of $47,000 credit.*—Subsection (a) shall be applied by substituting for "$47,000" the following amount:
>
> In the case of decedents dying in:
>
> | | |
> |---|---|
> | 1977 | $30,000 |
> | 1978 | 34,000 |
> | 1979 | 38,000 |
> | 1980 | 42,500 |
>
> (c) *Adjustment to Credit for Certain Gifts Made Before 1977.*—The amount of the credit allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the decedent after September 8, 1976.

(d) *Limitation Based on Amount of Tax.*—The amount of the credit allowed by subsection (a) shall not exceed the amount of the tax imposed by section 2001.

* * * * *

Section 2505 [as added by Section 2001(b)(2) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1849]. UNIFIED CREDIT AGAINST GIFT TAX.

(a) *General Rule.*—In the case of a citizen or resident of the United States, there shall be allowed as a credit against the tax imposed by section 2501 for each calendar quarter an amount equal to—

(1) $47,000, reduced by

(2) the sum of the amounts allowable as a credit to the individual under this section for all preceding calendar quarters.

(b) *Phase-in of $47,000 credit.*—Subsection (a)(1) shall be applied by substituting for $47,000" the following amount:

In the case of gifts made:

After December 31, 1976, and before July 1, 1977	$ 6,000
After June 30, 1977, and before January 1, 1978	$30,000
After December 31, 1977, and before January 1, 1979	$34,000
After December 31, 1978, and before January 1, 1980	$38,000
After December 31, 1979, and before January 1, 1981	$42,500

(c) *Adjustment to Credit for Certain Gifts Made Before 1977.* The amount allowable under subsection (a) shall be reduced by an amount equal to 20 percent of the aggregate amount allowed as a specific exemption under section 2521 (as in effect before its repeal by the Tax Reform Act of 1976) with respect to gifts made by the individual after September 8, 1976.

(d) *Limitation Based on Amount of Tax.*— The amount of the credit allowed under subsection (a) for any calendar quarter shall not exceed the amount of the tax imposed by section 2501 for such calendar quarter.

Section 2521 [prior to repeal by Section 2001 (b) (3) of the Tax Reform Act of 1976, Pub. L. No. 94-455, 90 Stat. 1849]. SPECIFIC EXEMPTION.

In computing taxable gifts for a calendar quarter, there shall be allowed as a deduction in the case of a citizen or resident an exemption of $30,000, less the aggregate of the amounts claimed and allowed as a specific exemption in the computation of gift taxes for the calendar year 1932 and all calendar years and calendar quarters intervening between that calendar year and the calendar quarter for which the tax is being computed under the laws applicable to such years or calendar quarters.

☆ U. S. GOVERNMENT PRINTING OFFICE: 1985 481531 10241